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JUL 31 1997

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax as an organization described in section 501(c)(9) of the Internal Revenue Code.

You were created [redacted] to provide self-funded medical benefits to employees of [redacted]. Full-time employees with [redacted] service are eligible to participate. Benefits are funded by employee and employer contributions, and the required contributions vary by job classification and type of coverage selected. For self-only coverage, professionals [redacted] contribute [redacted] % of the premium cost, or \$[redacted]. Nonprofessionals contribute [redacted] % of the premium cost, or \$[redacted]. For family coverage, professionals pay [redacted] % of the premium cost, or \$[redacted]. Nonprofessionals selecting family coverage pay the entire premium cost in excess of the employer's contribution for self-only coverage, or \$[redacted]. Thus, some employees receive a partial premium waiver benefit that is not available to all other employees.

You have provided the following data with respect to compensation and plan participation (as of [redacted]):

	Eligible Employees	Number Participating	Low Compensation	High
Professionals	[redacted]	[redacted]	\$[redacted]	\$[redacted]
Non-professionals	[redacted]	[redacted]	\$[redacted]	\$[redacted]

[redacted] other employees are excluded from participation because they are part-time employees. There are [redacted] persons employed by the plan sponsor.

Section 501(c)(9) of the Internal Revenue Code describes voluntary employees' beneficiary associations providing for the payment of life, sick,

[REDACTED]

accident, or other benefits to the members of such association or their dependents or designated beneficiaries, if no part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual.

Section 505(a)(1) of the Code provides, in relevant part, that an organization described in section 501(c)(9) will not be exempt unless it meets the requirements of section 505(b).

Section 505(b)(3) of the Code provides that in the case of any benefit for which some other Code section provides nondiscrimination rules, section 505(b) will be satisfied only if the nondiscrimination rules so provided are satisfied with respect to such benefit.

Section 105(h) of the Code and the regulations thereunder provide nondiscrimination rules for self-funded medical benefits.

Section 105(h)(2) of the Code provides that a self-insured medical plan satisfies the requirements of section 105(h) only if (A) it does not discriminate in favor of highly compensated individuals as to eligibility to participate; and (B) the benefits of the plan do not discriminate in favor of participants who are highly compensated individuals.

Section 105(h)(4) of the Code provides that a self-insured medical plan does not meet the requirements of section 105(h)(2)(B) unless all benefits provided for participants who are highly compensated individuals are provided for all other participants.

Section 105(h)(5) defines the term "highly compensated individual" to mean an individual who is one of the 5 highest paid officers, a shareholder who owns more than 10% of the employer, or among the highest paid 25% of all employees (other than employees described in section 105(h)(3)(B) who are not participants).

Section 1.105-11(c)(3)(i) of the Income Tax Regulations provides that benefits must not discriminate in favor of highly compensated individuals. Plan benefits will not satisfy the requirements of this subparagraph unless all the benefits provided for participants who are highly compensated individuals are provided for all other participants.

Nondiscriminatory Benefits Test

Treated as a single plan, your plan does not meet the requirement of section 105(h)(2)(B) of the Code and section 1.105-11(c)(3)(i) of the regulations because the highly compensated professional employees who are participating in the plan receive a partial premium waiver that is not available to the nonprofessional employees who are participating in the plan. However, if your plan is treated as two separate plans, one for professional employees and one for nonprofessional employees, the employer and employee contribution would be the same for the participants of each individual plan. Accordingly, each plan could meet the nondiscriminatory benefits requirements if tested separately.

Nondiscriminatory Classification Tests

a. Percentage Tests

Section 105(h)(3)(A) of the Code provides that a self-insured medical plan meets the requirements of section 105(h)(2)(A) if it benefits 70% or more of all employees (the 70% test), or 80% or more of all the employees who are eligible to benefit if 70% or more of all employees are eligible to benefit (the 70/80% test); or benefits such employees as a qualify under a classification set up by the employer and found not to be discriminatory in favor of highly compensated individuals (the classification test). One of these three tests must be satisfied, or the plan will be considered discriminatory as to eligibility for participation.

Section 105(h)(3)(B) permits certain categories of employees to be excluded from consideration. These are, in relevant part, employees who have not completed 3 years of service, employees who have not attained age 25, and part-time or seasonal employees.

Since we have already established that this plan, if treated as a single plan, provides discriminatory benefits, it is unnecessary to test as a single plan with respect to eligibility. Therefore, we will treat it as two separate plans for purposes of determining whether it is discriminatory with respect to its eligibility requirements.

If the plan is considered to be two separate plans, one for professionals and one for nonprofessionals, each plan must meet the eligibility requirements of section 105(h)(3)(A)(i). The largest number of employees participating under either plan is [REDACTED]. Accordingly, each plan fails the 70% test under section 105(h)(3)(A)(i). Of the [REDACTED] excludable employees, [REDACTED] are eligible to participate in the plan for

professionals. Thus, less than 70% of nonexcludable employees are eligible to participate and the plan for professionals could not meet the 70% part of the 70/80% test.

Because nonprofessional employees are eligible to participate in the plan for nonprofessionals, the plan meets the 70% part of the 70/80% test. However, 80% of the eligible employees (employees) would have to participate in order to qualify under the 80% part of the test, and only nonprofessional employees actually participated. Accordingly, if tested separately, neither plan could satisfy the percentage tests of section 105(h)(3)(A)(i) of the Code.

b. Alternative Classification Test

Therefore, if the plan is considered to be two separate plans, in order to satisfy the section 105(h) eligibility test, each plan must satisfy the classification test of section 105(h)(3)(A)(ii) of the Code. Section 1.105-11(c)(2)(ii) of the regulations provides that the existence of discrimination inherent in a plan's participation requirements may be judged on a facts-and-circumstances basis, using the same standards as are applied under Code section 410(b)(1)(B). Each plan could satisfy the eligibility requirements if it could meet either the current or prior law nondiscriminatory classification requirements of section 410(b).

As amended by the Tax Reform Act of 1986 (P.L. 99-514), section 410(b)(1) of the Code provides that a trust shall not be considered a qualified trust under section 401(a) unless it is designated by the employer as part of a plan which satisfies at least one of three requirements. These requirements are set forth in subparagraphs (A), (B), and (C) of section 410(b)(1). One of these requirements is the "average benefits test" described in section 410(b)(2). The latter is a two-fold test. One aspect of the test, described in paragraph (A)(i), requires that the plan benefit such employees as qualify under a classification that is not discriminatory in favor of highly-compensated employees.

Section 1.410(b)-4 of the regulations (entitled *Nondiscriminatory classification test*) provides rules for satisfying the requirements of Code section 410(b)(2)(A)(1). Any such classification must be both reasonable and nondiscriminatory. A classification, to be reasonable, must be established under "objective" and "bona fide" business criteria. Your classification appears to be objective. Under some circumstances, a classification between professionals and non-professionals might constitute a bona fide business criterion. On the other hand, the nature of your wage structure causes this classification to be, in effect, a

[REDACTED]

classification based on compensation. We therefore find that this classification is not "reasonable" within the meaning of section 1.410(b)-4(b) of the regulations.

Because a classification must be both reasonable *and* nondiscriminatory, your failure to satisfy the "reasonableness" standard makes it unnecessary to consider in detail whether the plan is also discriminatory. Furthermore, you have not provided sufficient information regarding the composition of the employer's work force to enable us to make this calculation with certainty. However, even using assumptions most favorable to the employer, the plan for professional employees is discriminatory under the standards of Code section 410(b)(2)(A)(i) and section 1.410(b)-4(c) of the regulations.

As noted above, we will also test your plan under the "old" requirements of Code section 410(b)(1)(B) as it existed prior to the enactment of the Tax Reform Act of 1986. These "old" nondiscrimination standards are set forth in section 1.410(b)-1(d)(2) of the regulations. A classification will satisfy these standards only if it is nondiscriminatory both on its face and in actual operation. Furthermore, a satisfactory classification will provide coverage to employees in all compensation ranges, with the lower and middle ranges being covered in more than nominal numbers.

In view of the fact that your classification is, in effect, a classification based on compensation, it does not cover employees in all compensation ranges. Accordingly, your classification does not satisfy the requirements of section 410(b)(1)(B) of the Code as it existed prior to the Tax Reform Act of 1986 (and as modified by section 105(h)).

Whether tested as a single plan, or as two separate plans, your plan does not meet any of the relevant nondiscrimination standards. Therefore, you do not meet the nondiscrimination requirements of section 505(b) of the Code and you are not exempt from federal income tax as an organization described in section 501(c)(9) of the Code.

You have the right to protest our ruling if you believe that it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement must be submitted within 30 days of the date of this letter and must be signed by one of your officers. You also have a right to a conference in this office after your statement is submitted. If you want a conference, you must request it when you file your protest statement. If you are to be represented by someone who is not one of your officers, he/she must file a

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proper power of attorney and otherwise qualify under our Conference and Practice Requirements.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key District Director. Thereafter, if you have any questions about your federal income tax status, including questions concerning reporting requirements, please contact your key District Director.

You will expedite our receipt of your reply by using the following address:

Internal Revenue Service
CP:E:EO:T:4, Room 6236
1111 Constitution Ave., NW
Washington, DC 20224

Sincerely,

Gerald V. Sack
Chief, Exempt Organizations
Technical Branch 4

cc: [REDACTED]

Code	CP:E:EO:T:4	CP:E:EO:R				
Surname	[REDACTED]	[REDACTED]				
Date						